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MISCELLANEOUS

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1946

No. 595

JULIA A. PERRINE AND MATILDA J. FELDMAN,
Petitioners,

vs.

THE PENNROAD CORPORATION, A CORPORATION OF THE STATE OF DELAWARE, AND THE PENNSYLVANIA RAILROAD COMPANY, A CORPORATION OF THE COMMONWEALTH OF PENNSYLVANIA

PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF THE STATE OF DELAWARE

To the Honorable the Chief Justice and the Associate Justices of the Supreme Court of the United States:

The Petitioners, stockholders of The Pennroad Corporation, respectfully pray that a writ of certiorari issue to review the final judgment of the Supreme Court of the State of Delaware in the case entitled Joseph W. Perrine and Julia A. Perrine, and Matilda J. Feldman, vs. The Pennroad Corporation, a Corporation of the State of Delaware, and The Pennsylvania Railroad Company, a Corporation of the Commonwealth of Pennsylvania, entered on May 27, 1946 (47 A. (2d) 479) (R. pp. 78-79), which affirmed

the decision and decree of the Court of Chancery of the State of Delaware in and for New Castle County in Perrine vs. Pennroad Corporation (43 A. (2d) 721) (R. pp. 32-48), issued on August 13, 1945, approving a certain settlement agreement dated March 2, 1945, by and between Pennroad and Pennsylvania, disposing of all pending litigation between them. (Petitioners will hereinafter be referred to as Perrine and/or Feldman; The Pennroad Corporation as Pennroad, and The Pennsylvania Railroad Company as Pennsylvania.)

Summary Statement of the Matter Involved

On October 18, 1932, Joseph W. Perrine (now deceased) and Julia A. Perrine instituted a derivative suit in the Chancery Court of New Castle County, Delaware, against The Pennroad Corporation, The Pennsylvania Railroad Company, the directors of Pennroad and the voting trustees of all of the Pennroad stock. Each defendant director of Pennroad was, at that time, also a director of Pennsylvania except one and he was formerly Treasurer of The Pennsylvania Railroad Company. The bill of complaint substantially alleged that Pennsylvania had caused the incorporation of Pennroad in April, 1929, as an investment trust for the purpose of acquiring without cost or risk to itself control of a number of railroads which could not have been acquired by Pennsylvania directly because of the regulations of the Interstate Commerce Commission and the prohibitions of the Clayton Act; that Pennsylvania clothed Pennroad with the appearance of a separate entity not subject to the jurisdiction of the Interstate Commerce Commission, but in fact controlled and dominated by Pennsylvania by means of a voting trust agreement, whereby all stock was to be deposited with certain voting trustees, all of whom were Pennsylvania officials, for a period of 10 years. The

bill further alleged that the defendant Pennsylvania deliberately concealed from subscribers to the stock of Pennroad its design and intention to operate Pennroad in the interest of Pennsylvania. Thereafter, approximately $141,000,000 was paid into the treasury of Pennroad by the investing public which relied upon the representations made by Pennsylvania. That pursuant to the plan for the domination and control of Pennroad, Pennsylvania caused Pennroad to acquire large blocks of securities in railroads desired by Pennsylvania at prices far in excess of their value, which acquisitions were in the interest of extending the railroad empire of Pennsylvania, but not proper investments for Pennroad. The bill prayed for an accounting for the enormous losses thereby sustained by Pennroad by reason of the unfaithful conduct of its affairs by the defendant Pennsylvania and the individual defendants; the cancellation of the voting trust arrangement as a fraudulent device; the election of an independent board of directors; the appointment of a temporary receiver and other further equitable relief.

Answers were filed by the defendants Pennroad, Pennsylvania and the voting trustees, the latter objecting to the constructive service of process upon them. Service of process was never obtained upon the other individual defendants. All of the defendants in their answers vigorously opposed the action and denied any wrongdoing. The case was still pending when on March 16, 1945 Pennroad filed a petition for approval of an agreement of settlement. Record, p. 1-9.)

In 1938, the Committee on Interstate Commerce of the United States Senate commenced an investigation of Pennroad and for the first time publicly recorded the facts establishing the definite control of it by Pennsylvania. (Part 21, Hearings Before a Subcommittee of the Committee on Interstate Commerce, U. S. Senate, 75th Cong., 3rd

Sess.; Sen. Report No. 25, Part 24, 76th Cong., 3rd Sess.) In 1939 and 1940 following the investigation, several other stockholders of Pennroad, Ione M. Overfield and Grace Stein Weigle, instituted proceedings against the same defendants in the District Court of the United States for the Eastern District of Pennsylvania. The cases were consolidated for trial. These related actions were substantially similar complaints based upon the facts alleged in the bill filed by the Perrines in 1932. Upon hearing in the said District Court, liability was imposed upon the defendant Pennsylvania, but the action was dismissed as to the individual defendants, the Court holding that the statute of limitations of the State of Pennsylvania barred the case as to them. (*Overfield* v. *Pennroad,* 42 F. Supp. 586 (1941).) The Court made specific findings of facts and conclusions of law.

At this juncture, Pennroad announced a change of position from that of active opposition to the suit for ten years to that of joining the complaining stockholders in seeking restitution. Following the appointment of a board of experts, damages were assessed against the defendant Pennsylvania in the amount of $22,104,515.92 (48 F. Supp. 1008 (1943)), although there was no authority to support the novel rule of damages applied by the Court which restricted the recovery to that amount. Cross appeals were filed by the litigants. On December 28, 1944, the Circuit Court of Appeals for the Third Circuit in a divided opinion affirmed the judgment in favor of the individual defendants and reversed the judgment against the Pennsylvania Railroad Company on the grounds of the applicability of the statute of limitations of the State of Pennsylvania (*Overfield* v. *Pennroad,* 146 F. (2d) 889 (1944)). It was specifically stated, however, that the decision was not on the merits. In a lengthy dissent, Justice Biggs, holding the statute of limitations inapplicable because the transaction was a continuing conspiracy, passed upon the

merits of the case and stated that both the corporate defendant and the individual defendants were liable for complete restitution of the full amount of the losses sustained by Pennroad, plus interest at the rate of 6% per annum to the date of the final judgment. This formula, as laid down in an exhaustive opinion, required the return to Pennroad of an amount approximating $200,000,000.

The facts as alleged in the complaints in the Perrine and Overfield-Weigle actions were found to be true and correct in the lengthy and sharply contested trial by the District Court and by the only Circuit Justice who reviewed the merits of the case.

The following findings are the judicial determinations establishing the liability of the defendants:

Pennsylvania prior to 1929 had been attempting to extend its influence and to build up its railroad empire by the acquisition of controlling interests in various railroads. Pennsylvania deemed these acquisitions essential to protect and extend its business, but was unwilling to purchase the securities of such railroads because of their speculative character, the excessive prices demanded and the doubts as to the legality of such acquisitions by Pennsylvania under existing law (Welsh, J., Findings of Fact 1, p. 621;[1] Biggs, J., pp. 904, 916, 908;[2] R. pp. 147-148).[3]

To acquire control of these railroads Pennsylvania formulated a scheme whereby the purchases could be made without any risk or expense to Pennsylvania, but still with complete control and domination of the railroads whose

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[1] All such references are to the decision of Welsh, J., 42 F. Supp. 586, in the Overfield-Weigle action.

[2] All such references are to the decision of Biggs, J., 146 F. (2d) 889, 901-932, in the Overfield-Weigle action.

[3] All such references are to the certified transcript of the minutes of the hearings on approval of the settlement agreement in the Court of Chancery of Delaware.

securities were so acquired vested in Pennsylvania (Biggs, J., p. 916; Welsh, J., Findings of Fact 22, p. 623.

In furtherance of said scheme Pennsylvania caused Pennroad to be incorporated as an investment company in Delaware on April 24, 1929, with powers to engage in almost every type of activity except banking and the operation of public utilities (Biggs, J., p. 904; Welsh, J., Findings of Fact 8, p. 621; R. p. 147).

As a step in connection with its plan of domination, Pennsylvania caused to be incorporated in Pennroad's charter certain provisions whereby it became practically impossible for stockholders to obtain any information concerning Pennroad's operations or to inspect any of its accounts, books, records or documents. Accordingly, the charter and by laws provided that unless authorized by the Board of Directors "the corporation shall not be required to make public in any manner to its stockholders or otherwise any statement concerning its assets, liabilities or earnings • • •" (Welsh, J., Findings of Fact 9, p. 622).

The Board of Directors elected by the Pennroad incorporators on the date of incorporation were Messrs. W. W. Atterbury, Jay Cooke, Richard D. Mellon, Levi L. Rue, Effingham B. Morris, Albert J. County, Henry H. Lee, and C. E. Ingersoll, all of whom were directors of Pennsylvania and a majority of Pennsylvania's Finance Committee. Atterbury was president of Pennsylvania, Morris was chairman of the Finance Committee, Cooke was chairman of the Road Committee, and many of the others held various important posts in Pennsylvania (Biggs, J., p. 904; Welsh, J., Findings of Fact 11, p. 622).

To insure its company control, Pennsylvania caused to be created for Pennroad a Voting Trust for a period of ten years, the limit permitted by law (Welsh, J., p. 599; Biggs,

J., p. 904; R. pp. 147-148). It was planned, as stated by W. W. Atterbury, the president of Pennsylvania, that before the expiration of the ten year term, suitable measures would be taken to insure longer control (Welsh, J., p. 599).

Through Pennsylvania's own bankers, Kuhn, Loeb & Company who had served their interests for more than half a century, of which firm George W. Bovenizer, a director of Pennroad continuously since 1932 to date, was then and still is a partner, there was sold to the public approximately $50,000,000 of Pennroad Voting Trust Certificates, out of which amount said Kuhn, Loeb & Company received as direct compensation $5,251,586 (Welsh, J., Findings of Fact 20, p. 623). Said funds were raised to pay for the acquisition of securities of Pittsburgh and West Virginia Railroad (Welsh, J., Findings of Fact 20, p. 623). The incorporation of Pennroad had been rushed to completion so that it might purchase these securities (Biggs, J., p. 905).

Thereafter, additional monies were raised by the further sale to the public of Voting Trust Certificates, in all aggregating approximately $140,000,000. The so called investments which Pennsylvania caused Pennroad to make and the amounts paid therefor were as follows:

1. In excess of 245,000 shares of the Detroit, Toledo & Ironton Railroad (hereinafter referred to as D. T. & I.)	$35,500,000	(Biggs, J., p. 905)
2. 10,000 shares of common stock of Lehigh Valley Railroad Company	$ 650,000	(Biggs, J., p. 912)
3. 222,000 shares of common stock of the Pittsburgh & West Virginia Railway Company (hereinafter referred to as P. W. V.)	$37,898,100	(Biggs, J., p. 908)
4. In excess of 21,000 shares of common stock of the Canton Company	$13,432,817	(Biggs, J., p. 907)
5. 402,119 shares of stock of the Seaboard Air Line Railway Company (hereinafter referred to as Seaboard)	$4,523,838.75	(Biggs, J., p. 911)

6. 148,800 shares of common stock and 1,200 shares of preferred stock of the New York, New Haven & Hartford Railroad Company	$17,301,851.25	(Biggs, J., p. 912)
7. 201,387 shares of various classes of preference stock, and shares of common stock of the Boston & Maine	$23,637,708.38	(Biggs, J., p. 912)
8. National Freight Company	$3,852,000	(Biggs, J., p. 916)

The D. T. & I. investment was excessive and Pennsylvania was unwilling to risk its own money "except on a firm contract with Ford" (Biggs, J., p. 905). Ford would not guarantee to continue to use D. T. & I. and it was decided in the words of Mr. County, a director of Pennsylvania and Pennroad, to "use the Pennroad Corporation" to make the purchase (Biggs, J., p. 906). Negotiations and arrangements were made for the acquisition by Pennroad even before its organization (Welsh, J., p. 625). Neither the president nor the vice president of Pennroad participated in the negotiations for the purchase and the Pennroad Board never even authorized the purchase until it had already been made (Biggs, J., p. 906). In the main, the road served the Henry Ford interests in traffic to and from the River Rouge plant, which traffic was not assured for D. T. & I. Prior thereto, its record for fifty years had been one of continuous failure. Twelve times in thirty-five years it had gone into receivership and twelve times the property had been sold at foreclosure sale. Pennroad's millions were risked for the traffic benefits to Pennsylvania and for no investment benefits to Pennroad (Biggs, J., pp. 905-907).

During 1928, Pennsylvania had been negotiating for the acquisition of the securities of the Canton Company, whose property consisted substantially of real estate. It had not acquired the same because it was unwilling to pay the price asked by the seller of about $600 a share (Biggs, J.,

p. 907). Nevertheless, in June, 1929, Pennsylvania caused Pennroad to embark on a real estate speculation by acquiring substantially all of the Canton Company stock for $13,432,817 or slightly in excess of $611 a share, notwithstanding that the valuation placed thereon by Pennsylvania was $9,500,000 (Biggs, J., pp. 907, 908) and by outside experts ranging from $2,772,000 to $6,241,000 (48 F. Supp. 1008, 1012).

Pennsylvania caused this purchase because it had estimated that control of Canton by it would result in business to Pennsylvania of 60% of Canton's business as against the 43% which it was receiving, with a net increase of freight revenue to Pennsylvania of approximately $577,000 per year (Biggs, J., pp. 907-908).

In September, 1929, Pennsylvania caused Pennroad to acquire 73% of the common stock of Pittsburgh, West Virginia Railroad for a grossly excessive purchase price of $37,898,100. At the time of the purchase said railroad was in financial difficulties and lacked working capital. Its securities were inflated and overpriced and even though pool operations had been operated and a reckless dividend policy pursued calculated to boost the market price to inflated figures, at no time did the New York Stock Exchange quotations ever approach the purchase price paid by Pennroad (Biggs, J., pp. 908, 910).

The purchase of D. T. & I., Canton Company and P. W. V. stocks was to bring the roads into the sphere of influence of Pennsylvania; to increase its freight traffic and improve Pennsylvania's competitive condition (Welsh, J., Findings of Fact 31, 32, p. 625).

In October, 1929, Pennsylvania caused Pennroad to purchase for $4,523,838 common stock of Seaboard, which was loaded with unnusually heavy fixed obligations. It had a poor earning record, no dividend declarations and was

faced with early maturities of large funded indebtedness of over $38,000,000 (Biggs, J., pp. 910-912). Pennsylvania caused Pennroad to risk $4,500,000 to gain $350,000. Seaboard finally ended in receivership (Biggs, J., p. 911).

During the period from July, 1929, until June, 1931, Pennsylvania caused Pennroad to purchase on the open market at excessive prices securities of Lehigh Valley Railroad Company, which were purchased only to further Pennsylvania's interest in said company (Biggs, J., p. 912).

During 1929 and 1930 Pennsylvania caused Pennroad to purchase on the open markets at excessive prices securities of New York, New Haven & Hartford and Boston and Maine for an aggregate purchase price of approximately $41,000,000.

Said purchases as well as the purchases of Seaboard and Lehigh Valley were made in furtherance of the plans and under the domination of Pennsylvania to bring a closer affiliation and operating alliance of those roads with Pennsylvania through the cooperative ownership of its instrumentality, Pennroad. The primary objectives sought by such purchases were benefits to Pennsylvania and not to Pennroad (Welsh, J., Findings of Fact 33, p. 625; Biggs, J., pp. 912, 913).

In 1928 Pennsylvania and the New York Central Railroad received freight forwarding business through Universal Car Loading and Distributing Company, a subsidiary of the United States Freight Company. During said year the New York Central acquired control of the Universal Car Loading and Distributing Company and Pennsylvania decided to go into the freight forwarding business and to operate a service which, in the testimony of Mr. County, "nobody's ownership of stock could disturb" (Biggs, J., p. 914).

Accordingly, Pennsylvania caused Pennroad to organize the National Freight Company at an estimated cost of $8,-

000,000 but over a period of several years the losses were so staggering that Pennroad poured into National Freight more than $4,000,000 all of which was completely lost. But at the same time, as a result of Pennsylvania's interest in the National Freight for whose benefit it was organized, Pennsylvania made profits of approximately $3,400,000 by way of rentals and freight charges (Biggs, J., pp. 913-916, 931).

Pennsylvania recognized its liability in connection with the National Freight venture and it was testified that Pennsylvania intended to make restitution. The National Freight venture alone occasioned the loss to Pennroad of $7,000,000.

The foregoing acquisitions by Pennroad, which cost approximately $140,000,000 and on which its shareholders had never received any returns by way of dividend or otherwise, except for small dividends in recent years, had depreciated in value to such an extent that at the time of the institution of the Perrine suit the same had a value of only a fractional part of their cost. Even today, after tremendous market rise in the value of their listed securities and attributing cost to certain of their closely held and unlisted securities, the book value is less than $50,000,000.

Honorable John Biggs, Jr. after reviewing the evidence with respect to the organization of Pennroad, its purpose and activities, summarized the transactions by stating that they:

> "constitute nothing more than steps in the execution of a whole and single plan conceived by Pennsylvania to make use of a corporate entity, Pennroad, represented to the security holders of the latter and to the public at large as an independent entity, to protect and enlarge Pennsylvania's railroad empire. Though Pennsylvania's course may be broken down into separate incidents, including the eight transactions com-

plained of, its conduct toward Pennroad was a continuous and uninterrupted execution of a whole and single plan. In determining certain aspects of the legal liability of the defendants we should look to that plan as a whole instead of to the separate incidents complained of, which were in fact but overt acts in a continuous civil conspiracy." (146 F. (2d) 889, 916)

The derivative suit filed in Delaware on behalf of Pennroad by Joseph W. Perrine (deceased) and Julia A. Perrine was still pending at this time and no bar of the statute of limitations was available to the defendants in that action. (R. pp. 93, 158.) Immediately following the decision in *Overfield* v. *Pennroad, supra,* negotiations looking toward a settlement were undertaken by representatives of Pennsylvania and Pennroad (R. pp. 150-151). At the close of these negotiations, it was the understanding of the Pennroad representatives that the settlement would be made in the United States District Court for the Eastern District of Pennsylvania (R. pp. 93-94, 107-111). The papers were were drawn by Pennsylvania (R. pp. 93-94, 108-109). Instead, it was provided therein that the settlement would be offered in Delaware. The reason advanced for the change was that Pennsylvania believed it could charge off most of the $15,000,000 in taxes by settling the case in Delaware rather than in the Federal Court which will be subsequently discussed (R. pp. 109, 140, 143). This was agreed to and on March 2, 1945, the agreement of settlement was concluded and ratified by the two corporations (R. pp. 1-9).

The settlement agreement called for the payment to Pennroad by Pennsylvania of $15,000,000, conditioned upon the termination and dismissal of the instant cause, the disposition of the *Overfield-Weigle* cases pending in the United States Circuit Court of Appeals for the Third Circuit by allowing the mandate to be entered therein and the time for applying for certiorari to elapse, a covenant by Penn-

road to bring no further suits on the matters contained in the several complaints and the execution of releases to all of the defendants and to the estates of the deceased defendants. A petition was then filed in the instant case in the Chancery Court of the State of Delaware in and for New Castle County, by Pennroad for an order approving the said settlement and directing it to be carried out (R. pp. 1-9). On March 19, 1945, upon order of the Chancellor, a date was fixed for hearing and provision made for publication of notice to the stockholders (R. pp. 9-15). The said hearing commenced on April 23, 1945. Pursuant to the said notice, Julia A. Perrine, the surviving complainant in the instant cause, and Matilda J. Feldman, a stockholder of Pennroad, appeared before the Court and entered written objections to the approval of the settlement (R. pp. 15-25, 26-31). Matilda J. Feldman requested an adjournment on the ground that the time allotted to the stockholders for preparation for the hearing was wholly inadequate. The Court denied the motion and ordered that all Objections on the part of all objecting stockholders be filed in writing by 2:00 p. m. the following day (R. pp. 88-89, 92). The answer filed by Julia A. Perrine objected to the settlement on the grounds that the amount offered was grossly inadequate, requested proof of the allegations contained in the petition and asked the case proceed to trial. Among the objections filed by Matilda J. Feldman were the following:

> 1. That the notice dated March 19, 1945 sent to stockholders did not constitute due and proper notice of the issues and that the same was false, misleading and evasive in that it failed to set forth that the reversal by the Circuit Court of Appeals of the Overfield and Weigle suit was not on the merits and that the Perrine suit was not affected by said reversal.
>
> 2. That the proposed settlement, as submitted to stockholders was predicated upon the alleged inde-

pendent judgment and determination of a free and uncontrolled Pennroad directorate upon which stockholders were entitled to and did in fact rely, whereas the said board of directors was under the complete domination and control of the Pennsylvania Railroad Company.

3. That the order of the Court of Chancery fixing the matter for hearing April 23, 1945 afforded complainant and other stockholders only approximately one month within which to inquire into and investigate the facts with regard to the agreement of settlement.

4. That the Court of Chancery had no jurisdiction to determine the settlement by reason of Rule 23 (c) of the Rules of Civil Practice for the District Courts of the United States adopted by the Supreme Court of the United States. (R. pp. 26-31.)

The burden of proof upon the issues was conceded by Pennroad to be upon Pennroad (R. p. 91).

After the presentation of the petitioners case, counsel for Perrine and Feldman moved to dismiss (R. pp. 164-184) and, also, at the end of the entire proceedings, counsel for both Perrine and Feldman again moved to dismiss on the following grounds (R. pp. 214-215):

1. That the Court had no jurisdiction over the proceeding because the notice of the hearing to Pennroad stockholders was false and misleading and had not been approved by the Securities and Exchange Commission, as required by Federal statute; that objecting stockholders had not been allowed proper time within which to file objections or answers; that the Court lacked jurisdiction to interfere with the *Overfield-Weigle* case then pending in the United States Circuit Court of Appeals for the Third Circuit and that its action with regard thereto was in contravention of Rule 23 (c) of the Federal Rules of Civil Procedure.

2. That the attempt on the part of the Court to entertain jurisdiction and the Court's rulings in connection with the hearings in limiting the evidence submitted by the objectants constituted a denial of the guarantees of due process of law as provided by the Constitution of the State of Delaware and the Fourteenth Amendment to the Constitution of the United States (R. pp. 88, 164-178, 214).

The Chancellor in his opinion rejected the objections raised to the jurisdiction of the Court of Chancery; rejected the objection that the approval of the petition effected a compromise and settlement of the *Overfield-Weigle* case in violation of Rule 23 (c) of the Federal Rules of Civil Procedure; rejected the contention as to the inadequacy of the notice given to stockholders; rejected the objection that the board of directors of Pennroad Corporation were not unbiased in sponsoring the $15,000,000 settlement; held that because of the finding that the directors were free from disqualifying interests and acted in good faith that there was "no need to inquire into the merits of the settlement" (R. pp. 32-47).

On August 13, 1945, the Chancellor signed a decree approving the settlement as submitted and authorizing Pennroad to carry it into execution (R. pp. 47-48). Subsequently, on September 12, 1945, a petition for reargument and rehearing was filed by Julia A. Perrine in the said Chancery Court (R. pp. 47-53). The said petition for rehearing and reargument alleged that the issues raised for the approval of settlement were never defined; that the Court deliberately refrained from passing upon the adequacy or fairness of the proposed settlement, or its relation to the best interests of the Corporation, or to consider proffered evidence thereon; that for the first time, it appeared that the Court never intended to pass upon the merits of the settlement and that its ruling denied

Julia A. Perrine of property without due process of law as guaranteed by the provisions of the Fourteenth Amendment to the Constitution of the United States. The said petition for rehearing and reargument was dismissed by decree of the Chancellor on September 22, 1945 (R. p. 53).

Both Julia A. Perrine and Matilda J. Feldman appealed to the Supreme Court of the State of Delaware. Among the Assignments of Error (R. pp. 54-60) it was urged:

1. That the Court of Chancery had no authority to render the decree without passing upon the merits of the settlement.

2. That the Chancery Court lacked jurisdiction to approve the settlement of litigation pending in a Federal Court which litigation could only be settled pursuant to the provisions of Rule 23 (c) of the Federal Rules of Civil Procedure.

3. That the notice of the hearings furnished the stockholders was grossly inadequate, unfair, misleading and evasive and in violation of the Securities Exchange Act of 1934 and the Rules and Regulations promulgated thereunder and that the Chancellor erred in holding otherwise.

4. That there were no facts adduced before the Chancellor which justified a finding that the settlement was not disproportionate to the amount which could have been recovered in the Perrine action.

5. That there were no facts adduced before the Chancellor which justified a finding that the Pennroad Board acted in good faith and was free from disqualifying interests.

6. That the position of Perrine in the Delaware litigation commenced in 1932 could not be usurped by the Pennroad Board unless and until clear and convincing proof

had been adduced, establishing the fairness and adequacy of the settlement.

7. That by reason of the foregoing the objectants were deprived of substantial rights which resulted in a denial of due process to the objectants and other stockholders of Pennroad in violation of the guarantees of due process under both the Federal and State Constitutions.

The Supreme Court of Delaware affirmed the decision and decree of the Court of Chancery (47 A. (2d) 479) (R. pp. 60-78). Final judgment was entered on May 27, 1946 (R. pp. 78-79).

On May 18, 1946, Julia A. Perrine filed a petition for rehearing in the Supreme Court of the State of Delaware allegnig, *inter alia*, that the *Overfield-Weigle* cases, then pending in the Court of Appeals for the Third Circuit, were being settled in a State Court in contravention of Rule 23 (c) of the Federal Rules of Civil Procedure and the settled policy of the Federal Courts and that thereby the Courts of the State of Delaware were trespassing upon the jurisdiction of the Federal form; and that the ruling of the said Court, in considering and approving a settlement of a stockholders derivative suit without consideration of the merits of the settlement, deprived the said Julia A. Perrine and other stockholders of property without due process of law as guaranteed by the Fourteenth Amendment of the Constitution of the United States (R. pp. 79-86). On May 27, 1946 the said petition was dismissed and the final judgment as above noted was entered.

Jurisdiction

1. The jurisdiction of the Court is invoked under Section 237 (b) of the Judicial Code as amended; 28 U. S. C. A. Sec. 344 (b). The judgment of the Supreme Court of Delaware was entered on May 27, 1946. The time within which

to present this petition for a writ of certiorari has been extended to October 11, 1946.

2. The jurisdiction of this Court is sustained by the following cases:

Windsor v. *McVeigh*, 93 U. S. 274, 282-284, 23 L. Ed. 914;

Morgan v. *U. S.*, 304 U. S. 1, 19-20 (1938);

Jones Nat. Bk. v. *Yates*, 240 U. S. 541, 36 S. Ct. 429, 433 (1916);

Anderson Nat. Bank v. *Luckett*, 321 U. S. 233, 246 (1944);

Steele v. *Louisville and N. R. Co.*, 323 U. S. 192, 204, 65 S. Ct. 226, 233 (1944);

Miles v. *Illinois Central R. Co.*, 315 U. S. 698, 700, 62 S. Ct. 827, 829 (1942);

Straus v. *American Publishers Assn.*, 231 U. S. 22, 34 S. Ct. 84 (1913);

Missouri, Kansas & Texas Ry. Co. v. *Haber*, 169 U. S. 613, 18 Sup. Ct. 488;

A. C. Frost & Co. v. *Coeur D'Alene Mines Corp.*, 312 U. S. 38, 61 S. Ct. 414;

Endicott-Johnson Corp. v. *Encyclopedia Press, Inc.*, 266 U. S. 285, 288, 45 S. Ct. 61.

3. Statutes.

Rule 23 (c) of the Federal Rules of Civil Procedure, U. S. C. A. Title 28, following Section 723 (c), provides as follows:

> "Dismissal or Compromise. A class action shall not be dismissed or compromised without the approval of the court. If the right sought to be enforced is one defined in paragraph (1) of subdivision (a) of this rule notice of the proposed dismissal or compromise shall be given to all members of the class in such manner as the court directs. If the right is one defined in

paragraphs (2) or (3) of subdivision (a) notice shall be given only if the court requires it."

The foregoing rule was promulgated pursuant to Congressional Act of June 19, 1934, Chapter 651, Sections 1 and 2 (48 Stat. 1064, U. S. C., Title 28, Sections 723 b, 723 c).

General Rules and Regulations of the Securities and Exchange Commission:

Rule X-14A-3 (a)—

"The information included in proxy soliciting material shall be clearly presented and the statements made therein shall be divided into groups according to subject matter and the various groups of statements shall be preceded by appropriate headings. The order of items and sub-items in the schedule need not be followed provided that the information is furnished in a manner which will not tend to obscure the effective presentation of information to the persons solicited."

Rule X-14A-5—

"No solicitation subject to section 14 (a) of the Act shall be made by means of any form of proxy, notice of meeting, or other communication containing any statement which, at the time and in the light of the circumstances under which it is made, is false or misleading with respect to any material fact, or omits to state any material fact necessary in order to make the statements therein not false or misleading * * *."

The foregoing rule was promulgated pursuant to the Securities Exchange Act of 1934, June 6, 1934, Chapter 404, Section 23, 48 Stat. 901, as amended, Title 15, U. S. C. A., Section 78 w.

4. The constitutional and Federal questions were raised by petitioners at their first opportunity and were pressed throughout. They were raised by both Perrine and Feldman in the Court of Chancery in and for New Castle County

at the outset of the hearing by appropriate motions to dismiss made at the end of Pennroad's case before the Chancellor upon the hearing on the approval of the settlement (R. pp. 164-184), and at the end of the entire proceedings (R. p. 214). The constitutional questions were raised by Perrine in the petition for rehearing and reargument filed with the Chancery Court. The questions were raised and discussed in the briefs of the appellants in the Supreme Court of the State of Delaware (R. pp. 54-60). The Supreme Court of Delaware referred to only one phase of the constitutional law problem urged by appellants when it said at 47 A. (2d) 479, 486:

> "There is no ground for the contention that the Vice-Chancellor's refusal to admit all the evidence offered by the objectors concerning the merits of the Perrine case violated the Constitution of the United States and the Constitution of the State of Delaware by denying to the objectors due process of law" (R. p. 71).

It is obvious from the assignments of error, particularly assignments numbered 28 and 38, that petitioners urged that they had been denied their constitutional rights of due process of law guaranteed by the Federal Constitution because of the failure or refusal of the Chancellor to inquire into the merits of the *settlement*. In the petitioners' briefs submitted to the Supreme Court of Delaware it was specifically stated that the Chancery Court had no jurisdiction or authority to approve the settlement without passing upon the merits thereof, and the Court's refusal so to inquire resulted in a denial of due process.

With respect to Rule 23 (c) of the Federal Rules of Civil Procedure, the Supreme Court of Delaware said (R. p. 70):

> "It is admitted that the Court of Chancery of this State cannot by its decree dismiss the Overfield and Weigle actions now pending in the United States Dis-

trict Court for the Eastern District of Pennsylvania, or take any action which will be binding on that Court. But in a stockholders derivative suit such as this is, where the controversy has been settled, after full hearing, before some other Court having jurisdiction, it is competent for the Court of Chancery to entertain a petition for approval of a settlement agreement such as the one filed in this case."

The assignments of error and the questions presented to the Supreme Court of Delaware in petitioners' briefs and in oral argument, as in the Chancery Court below, also urged the violation of the provisions of a Federal statute with respect to the nature of the notice required to be given under provisions of the Securities Exchange Act of 1934 and the rules and regulations promulgated thereunder as herein above set forth, namely, that the said notice was inadequate, misleading, evasive and false.

The constitutional questions were renewed by Perrine in her petition for rehearing filed in the Supreme Court of the State of Delaware on May 18, 1946, which was denied on May 27, 1946, at which time final judgment was entered.

The Questions Presented

1. Did the Chancery Court of the State of Delaware have the right, authority or jurisdiction to consider the settlement and dismissal of litigation pending in a Federal Court and to approve and authorize its termination?

2. Have the Courts of Delaware been used to evade the provisions of Rule 23 (c) of the Federal Rules of Civil Procedure?

3. Was the notice dated March 19, 1945, with respect to the hearings before the Vice-Chancellor inadequate, misleading, evasive and in violation of the General Rules and Regulations promulgated by the Securities and Exchange

Commission pursuant to the Securities Exchange Act of 1934?

4. Does the judgment of the Supreme Court of Delaware affirming the order of the Chancery Court of said State on a decision of the Vice-Chancellor made without inquiry into the merits of the settlement constitute or result in a denial of due process guaranteed petitioners under the Fourteenth Amendment to the Constitution of the United States, particularly in the light of the nature of the case, the purposes of the procedure and its effect upon the rights of the petitioners and all other stockholders of Pennroad?

5. Was the said notice dated March 19, 1945, inadequate, false, misleading or evasive and when coupled with repeated denials of petitioners' motions to adjourn in order more fully to prepare for the hearings a deprivation of petitioners constitutional rights of due process of law as guaranteed by the Fourteenth Amendment to the Constitution of the United States?

Specification of Errors

The errors of which petitioners complain and intended to be urged are implicit in the questions presented above and we respectfully request that the same be deemed incorporated herein as though set forth at length.

Reasons for Granting Writ

Substantial questions of substantive and procedural due process are inherent in this case. The questions presented raise for review the important and far-reaching issue of the proper disposition by compromise of stockholders suits in State Courts and in particular whether the setlement of such suits can be transferred from a Federal to a State Court which assumes to act in derogation of a settled Fed-

eral legislative and judicial policy. Not only because of the magnitude of this litigation and the substantial sums of money involved herein but also because of the important effect of the unusual and unwarranted procedure of the Delaware Courts on stockholders litigation are these questions deemed worthy of consideration by this Honorable Court. For, this litigation involves more than a question of property rights in the instant case. It involves questions of corporate conduct and morality under the laws of the State of Delaware which has general jurisdiction over a vast amount of the nation's corporate business. The investing public generally is affected by the rulings of the Delaware Courts on matters of corporate law, particularly where rights of judicial supervision and protection are concerned.

One of the primary questions gravely affecting petitioners constitutional rights is based upon the order of the Chancery Court of Delaware entered without any inquiry into the merits of the settlement. The unusual gravity stems not only from the failure so to inquire but from specific disclaimer on the part of the Court of the necessity for the inquiry. This Honorable Court will note that the litigation sought to be settled had its origin in wrongs committed by the defendants many years ago and 14 years ago petitioner Perrine sought redress in the Courts of Delaware. During all these years said petitioner has been unable to obtain a trial of the action in the Delaware Courts, has been confronted with a bitter resistance by most of the directors who now seek to foreclose not only any inquiry into the merits of the case, but any inquiry into the merits of the settlements. And now the Delaware Courts have said that the suit may be dismissed and the settlement approved without any inquiry into the merits of the settlement even though the amount offered represents a

small fractional part of the restitution rightfully due Pennroad.

This Court is familiar with the background and history of stockholders derivative actions and the unsavory practices and abuses which attended their settlement. Indeed, it was such practices which gave rise to Rule 23 (c) promulgated by this Court for the very purpose of safeguarding the rights of all parties against such practices and the unwholesome and unfair results attendant.

In the case of *Winkelman* v. *General Motors Co.*, 48 F. Supp. 490 (1942), and the related cases reported in said volume, Leibell, J. commented upon Rule 23 (c) and the reasons which gave rise to its promulgation. On page 514, it was observed as follows:

> "Of course, Rule 23 (c) contemplated the compromise of stockholders suits, under proper supervision of the Court. The rules have the effect of a statute. A question of public policy had developed in actions of this type, due to the private and secret settlement of stockholders suits, made without Court review and without notice to other stockholders. Against that unsavory practice the corrective provisions of Rule 23 (c) were directed."

Concerning the role of the Court in the required judicial supervision and the scope and extent of such judicial supervision, Leibell, J. quoted approvingly the decision of Mr. Justice Rosenman of the New York Supreme Court in *Neuberger* v. *Barrett,* Sup. Ct., N. Y. Co. (June 25, 1942, no opinion for publication).

> "The role of the court is to see that the compromise is fair and reasonable under the circumstances and that no collusion or fraud has been practiced in the consummation of the settlement. To do this the court must weigh the probabilities and possibilities of victory or defeat as indicated by the legal or factual

> **situation presented. If such considerations lead to the conclusion that the settlement agreed upon by the plaintiffs in the suit is not unfair or unreasonable to the corporation (in which all the other stockholders have their interest), then the action of the plaintiffs in compromising the suit should be approved."**

In *Cohen* v. *Young*, 127 F. (2d) 721 (C. C. A. 6th, 1942) the Court used even stronger language defining the duty of the Court in considering the settlement of stockholders derivative actions. At pages 725 and 726, it was stated that the Court had to give full consideration to all of the facts with reference to the *adequacy and fairness of the settlement*, that the stockholder had a right to invoke the discretion of the Court to decide whether the compromise recommended did *in fact* protect the interests of the corporation and of the stockholders and that it was the *duty* of the Court to consider the evidence in this light and the failure or refusal of the Court so to consider it on the ground that it had no power or discretion deprived the stockholders of a *substantial right;* that the rule was adopted to secure not routine approval of a consent decree, but to insure *supervision* of the Court for the protection of the corporation and all the stockholders.

A similar holding is found in *Piccard* v. *Sperry Corporation*, 36 F. Supp. 1006, 1009, affirmed 120 F. (2d) 328 (C. C. A. 2nd, 1941).

To the same effect are *Bysheim* v. *Miranda*, 44 N. Y. S. (2d) 15; *Beeber* v. *Empire Power Corporation*, 31 N. Y. S. (2d), 914; *Emmerich* v. *Loft, Inc.*, Del. Ch. (July 10, 1939) (not officially reported). The principles have been accepted in Delaware in connection with the settlement of suits involved in an estate litigation. *In re Ortiz's Estate*, 27 A. (2d), 368 (D. Ch. 1942). It was contended in the Chancery Court and the Supreme Court of Delaware that the Delaware law applicable to the function of the

Court in sett'ement proceedings was correctly stated in the *Oritz* case as follows:

> "The principal matters that should be considered by the Court, in reaching a conclusion to approve or disapprove the proposed compromise, have frequently been stated to be,—
>
> "(1) The probable validity of the claims.
>
> (2) The apparent difficulties in enforcing the claims through the courts.
>
> (3) The collectibility of any judgment recovered.
>
> (4) The delay, expense and trouble of litigation.
>
> (5) The amount of the compromise as compared with the amount and collectibility of a judgment.
>
> (6) The views of the parties involved, pro and con.
>
> "Upon a consideration of these factors, a conclusion must be arrived at as to whether or not a compromise is for the best interests of the claimant.
>
> "Testing the facts by these considerations, I am of the view that the offers are for the best interests of the estate and should be approved."

The *Ortiz* case apparently is still the law of Delaware. It was cited with approval by the Delaware Supreme Court. The language therein stopped short of the specific tests which stated that in considering the *propriety and sufficiency* of the settlement due weight must be accorded to various factors, among which were the probable validity of the claim, the amount of *probable recovery as estimated* and the relation between the amount of the settlement and the probable recovery (R. p. 75). It is clear that the Court in the *Ortiz* case inquired into the merits of the settlement.

The *Ortiz* case and the tests laid down therein had their origin in a stockholders derivative action, *Emmerich* v. *Loft, Inc.*, Del. Ch. July 10, 1939, (not officially reported). It appears, therefore, that the Delaware law still requires inquiry into the merits of the settlement. Under such a

state of law petitioners were not accorded equal protection of the laws and the failure and refusal to accord such protection constituted a denial of due process. Even more to be questioned is the fact that it has been made to appear that petitioners were afforded equal protection under the laws of Delaware. Of course, even if the Delaware law should not permit inquiry into the merits of the settlement, it is contrary to the provisions of due process on the basis of the authority cited by the Delaware Supreme Court. There the meaning of "due process" was stated to be, quoting from *Pennoyer* v. *Neff*, 95 U. S. 714 as "they mean a course of legal proceedings according to the rules and principles which have been established in our system of jurisprudence for the protection and enforcement of private rights." (R. p. 71).

Do not the adjudicated cases and the Federal Rules of Civil Procedure and the reasons therefor amply demonstrate the rules and principles which control the Courts in supervising the settlement of a stockholders derivative action.

The Delaware Supreme Court also quoted from *Anderson National Bank* v. *Luckett* (321 U. S. 233 (1944)) as follows:

> "The fundamental requirement of due process is an opportunity to be heard upon such notice and proceedings as are adequate to safeguard the rights for which the constitutional protection is required. If that is presented the demands of due process are fulfilled."

Do not the authorities prove that the only proceedings adequate to safeguard the stockholders rights are the complete supervision of the Court after full inquiry into the merits of the settlement and a decision based upon and supported thereby.

In the *Cohen* case, *supra,* and other cases, the inquiry into the merits of the settlement was not made because of any

lack of good faith, but because the Courts recognized that it was their role, function and duty so to inquire. Good faith was certainly one of the elements in considering whether the settlement was fair and equitable, but it was not the sole determinative basis or standard.

Have the requirements of due process as laid down in the decisions of this Court been satisfied by the routine approval of the settlement authorized without any inquiry at all into the merits of the settlement? Does such a standard conform to the civilized standards as practiced universally in the Courts which standards are made the prerequisites in determining whether due process has been observed. *Hysler* v. *State of Fla.*, 315 U. S. 411, 413, 62 S. Ct. 688, 690 (1942).

In view of the universal acceptance of the function and duty of a Court in its supervision of settlements of stockholders derivative actions, it is questionable whether the determination of the Chancery Court of Delaware conforms to the requirement of judicial due process under the established "systems of jurisprudence." *Endicott Johnson Corp.* v. *Encyclopedia Press,* 266 U. S. 285, 288 (1924); *Pennoyer* v. *Neff*, 95 U. S. 714, 733 (1878).

If there ever were a case where the merits of the settlement should be examined and considered, and it is submitted that the law universally requires such inquiry, this case presents outstandingly the necessity for such inquiry. For years the Pennroad Board of Directors resisted the litigation. The Board, its voting trustees and successor officers and directors were judicially disqualified by specific finding of Judge Welsh. (*Overfield* v. *Pennroad Co.,* 42 F. Supp. 586, 624.) The *Overfield* case in both the District Court and the Circuit Court of Appeals is replete with findings which would make suspect any proposal for settlement.

In the related case of *Feldman* v. *Pennroad,* in which a petition for writ of certiorari is likewise simultaneously

being sought, the United States District Court for the District of Delaware, Bard, J., certainly thought that the inquiry and determination in the Delaware Court would be adequate and he so stated in his reported opinion. (*Feldman* v. *Pennroad,* 60 F. Supp. 716, 718-719 (1945).)

The Supreme Court of Delaware was apprised of the fact that the Feldman litigation had been dismissed by Judge Bard in the United States District Court of Delaware and the Chancery Court had likewise been advised prior to the decision of the Vice-Chancellor. The refusal, therefore, to inquire was all the more grievous inasmuch as the result was that neither Court inquired into the merits of the settlement.

With respect to the matter of jurisdiction, it may fairly be inquired whether the Delaware Chancery Court had any jurisdiction at all. Certainly in the usual litigation the parties may not come into the Court and ask for the Court to sit as an arbitrator. That is not the role of the Court. The parties themselves may undertake to settle their own affairs, but where one party seeks exculpation or exoneration by petition presented to the Court, the Court if it has any jurisdiction at all must exercise such jurisdiction in a manner appropriate to the purposes and in accordance with the procedures designed to protect the interest of the parties. Such is the requirement of "due process."

If the Delaware Chancery Court would otherwise have jurisdiction, there is still some question whether the Court may exercise jurisdiction where the petitioner Perrine, plaintiff in the action sought to be settled, vigorously objects to the settlement as unfair and inequitable. (*Cf. Eagle Iron* v. *Colyar,* 156 F. 954 (1907); *U. S. Lines* v. *U. S. Lines Co.,* 96 F. (2d) 148 (C. C. A. 2nd, 1938); *General Inv. Co.* v. *Addinsell,* 25 App. Dv. 377 (N. Y. 1938). It cannot be denied that the jurisdiction entertained by the Delaware Chancery Court was subject to the limitations to hear and determine

in accordance with the well established rules of due process as set forth in the decisions of this Court, note particularly *Windsor* v. *McVeigh, supra.* Without such judicial inquiry, petitioners are met with a denial of their day in Court and a denial of due process of law. As was aptly stated in *Consolidated Gas Co.* v. *Mayer,* 146 F. 150, 152 (1906):

> "* * * Every individual who feels himself aggrieved either by the action of some other individual or of the state or the nation is secured the right to bring his grievance before some court. It may be a court of law or of equity, a court established by a statute, or by a Constitution, a state court or a federal court, but somewhere or other there is provided for him a forum to which he can present his case, can support it by proof, and have his hearing. That is 'due process of law', a heritage from long centuries of struggle which this nation and its constituent states have deposited in the cornerstones of their written Constitutions. Everyone is entitled, sometime, somewhere, to his 'day in Court.'"

In addition, the Court may consider whether the State Courts have been used to evade the hearing in the Federal Court pursuant to Rule 23 (c) of the Rules of Civil Procedure. The *Overfield-Weigle* case was pending and it was so held in *Dickheiser* v. *Pennsylvania R. Co.,* 5 F. R. D. 5 (E. D. Pa. 1945).

It is clear that it was originally planned to settle the Overfield-Weigle actions in the Federal Courts. The record shows (R. pp. 93-94, 107-111) that counsel for Pennroad so thought. Further, at the time the "negotiations" for settlement were virtually completed in February 1945, the following notice was sent to the stockholders (R. pp. 92-93, 172-173):

> "Attention is called to the existence of the Perrine suit in Delaware, which is believed not barred by the statute of limitations, and that, *if the Overfield-Weigle cases were not settled on their merits,* plaintiffs would

be permitted to pursue the Perrine suit under the Delaware law." (Italics ours.)

It is our contention that after certain discussions concerning the requirements of Rule 23 (c) (R. pp. 93-94, 109-111) the parties decided to use the Delaware Courts for their settlement proceedings. It has been stated that the reason was to obtain a tax deduction, although in view of the fact that the Overfield-Weigle action was then pending, it is difficult to understand why the payments would be deductible if made by order of the Delaware Court and not deductible if made by order of a Federal Court (R. pp. 142-144).

As regards the matter of the notice, the Court will observe that the notice to the stockholders (R. pp. 9-15) failed to state that the *Overfield-Weigle* case was not decided on the merits and that the *Perrine* case was not subject to the infirmity of the statute of limitations (R. pp. 158, 170-174), failed to state that if the *Perrine* case were prosecuted a judgment in the amount of $200,000,000 might be obtained as announced by Mr. Justice Biggs and failed to state that the individual defendants were not making any contribution to the settlement although they and their estates were being released from all liability. Such omissions and misstatements and various others could not have occurred had the notice been in the form required by the General Rules and Regulations promulgated by the Securities and Exchange Commission and had the hearing been conducted pursuant to Rule 23 (c) of the Federal Rules of Civil Procedure.

Conclusion

Wherefore, your petitioners respectfully pray that a Writ of Certiorari be issued out of and under seal of this Honorable Court directed to the Supreme Court of the State of Delaware commanding that Court to certify and to send to this Court for its review and determination, on a day

certain to be therein named, a full and complete transcript of the record and of proceedings herein; and that the judgment of the Supreme Court of the State of Delaware be reversed by this Honorable Court, and your petitioners have such other and further relief in the premises as to this Honorable Court may seem meet and just.

Respectfully submitted,

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